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SUBJECT: SE TURKEY: INFRASTRUCTURE, SECURITY HINDER INCREASED TRADE WITH IRAQ

REF: A. A) ANKARA 648
 1B. B) ANKARA 5996
 1C. C) BAGHDAD 503

1.(SBU) Summary: Exports from southeast Turkey to Iraq increased in 2004 over the previous year (septel), but many factors conspire against further increases in this trade: a single border gate between the two countries, sub-standard roads leading to the gate, Iraq's security situation and underdeveloped banking system, and the difficulty in obtaining insurance for trade and investment lending related to Iraq. Increased trade is unlikely to make a major contribution to the economy of southeastern Turkey until some of these challenges are addressed. End summary.

Challenges I: Infrastructure and Security

12. (SBU) Exports from southeast Turkey to Iraq increased in 2004 over the previous year (septel), but several obstacles stand in the way of a further increase in trade. There is but one single border crossing between the two countries, at the Habur/Ibrahim Khalil Gate. Exporters in the region are unanimous in their call for a second border gate to be developed, calling the current one - with considerable understatement -- "very uncomfortable." Transporters routinely wait for many hours to head southbound, and sometimes even seven to ten days to return northbound. A modernization project at the gate reportedly is due to commence this spring (ref A). While it could conceivably have a temporary and short-term negative effect on throughput, the project should lead to facilitation of trade in the long-term. Nevertheless, even the modernization project will not be enough, say exporters; they want a second gate.

13. (SBU) Aside from the border gate itself, the abhorrent state of infrastructure leading to the Habur Gate is a deterrent to healthy trade. Heading east from Adana, when the highway ends in Gaziantep, truckers have approximately 400 more kilometers to travel - on a dangerous, damaged and overused two-lane road - before reaching the border crossing. (Note: Concern about the harmful impact of truck traffic on this already sub-standard road is starting to show in Turkish Minister of Transportation unwillingness to grant exceptions to a "three quarters-full" loading policy - which aims to reduce spillage and wear and tear - for sustainment fuel tankers. End note.)

14. (SBU) Trucker security (ref B) in Iraq is another well-known challenge for the time being. (Note: A trilateral dialogue is ongoing to address this issue, where a downturn in violence toward Turkish truckers is detectable anecdotally in the last three months. End note.) Security problems have led to sharp increases in transportation costs. One Mersin exporter shared that he paid \$40 per ton of cargo transported in the past, but is now paying \$90. He attributed the rate increase solely to perceptions of security risks. (Note: According to trucker union representatives, this increase in cargo haulage costs has not translated into appreciably higher trucker salaries, presumably because the increase in cost goes primarily to companies, not to individual truckers. End note.)

Challenges II: Banking and Insurance

15. (SBU) The inadequacy of the banking system within Iraq (ref C) also dampens enthusiasm for bigger business with the country for the moment. One contact conceded that banks do exist, but says the system has not been firmly established yet. There are not enough branches, for example, and wire transfers are impossible. "I would be happy to wait for up to ten days for a wire," said one businessman, "rather than bringing cash across the border." Wire transfers will also decrease the amount of bribes that customs officials are charging, they assert. One contact went so far as to say that with settlement of U.S. contracts in Iraq in cash, the U.S. is exposing its contractors to hostage-taking and predatory criminal activity, carried out by some to finance the insurgency.

16. (SBU) A related challenge faced by some Turkish exporters, particularly when selling to the Iraqi Interim Government (IIG),

was the retrieval of bank guarantee letters after a transaction had been completed. For example, when contracting orders with a Mersin-based cereals and legume company, the IIG required a bank letter demonstrating that the company could fulfill the order. After orders were filled, however, it took this company two and even three months, sometimes, to get their notes back from the IIG. In the meantime, until the note was returned to the bank, the bank was requiring that the company deposit in cash the amount that had been guaranteed.

¶7. (SBU) Yet another problem for those thinking of doing serious business in Iraq is the difficulty in getting insurance on investments there. According to comments made by a high-level AIG Sigorta representative at a recent conference, some insurance for exports to Iraq is available, but it is quite expensive. Another AIG contact claimed that AIG itself was writing policies for exports to Iraq, but stopped doing so four months ago after having to pay out significant damages. Now they will insure goods only as far as Habur Gate. Reflecting the difficulties in ascertaining exact information about insurance options, an AKBank contact in the region told us that his company had just finalized its insurance policy for exports to Iraq, though they were not going to finance investments there. An Istanbul-based representative of the same firm said, however, that they had been writing policies on exports to Iraq, but that two months ago they suspended doing so when the risks became too great.

Financing trade

¶8. (SBU) In discussions with Adana-based regional bankers such as AKBank and Oyak-Bank, there are steady reports that 2004 did not see as much Iraq-related lending or banking activity, such as requests for letters of credit, as 2003. They report that 2003's higher levels of business were driven by truck financing as transport companies and small independent truckers financed new long-haul transportation for Iraq. Such lending did not recur at the same level in 2004. They also report that Eastern Mediterranean Turkey's financial health is still "in transition," with many clients breaking even, little new investment, and the region's big private capital holders (AK says its Adana-based private investment group is Turkey's largest at over 150 clients with average 750,000 to \$2 million balances) on the sidelines.

¶9. (SBU) In addition to this lending sector, both 2003 and 2004 saw steady lending for construction material purchase for contractors, working capital for construction and service operators (such as SERKA in Adana which charters vehicles and aircraft - mainly former Soviet airframes, such as Antonov and Ilyushin - for deliveries to northern Iraq) and spare parts ordering for Turkish service contract providers to U.S. bases north of Baghdad.

¶10. (SBU) Comment: Increased trade is unlikely to make a major contribution to the economy of southeastern Turkey until the security situation in Iraq improves and the transportation bottlenecks are eliminated. End Comment.

11.(U) BAGHDAD MINIMIZE CONSIDERED.

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